access product markets. IXCs have no practical alternative but to purchase exchange access from ILECs. Competition, to the extent it exists at all, exists only at the most minimal levels.

Exchange access service provides the essential originating or terminating connection between an IXC point of presence (POP) and a customer location. When a monopolist provides this connection, it can impose a "significant and nontransitory increase in price" because there is no "substitute service" to which an IXC can switch if it is to continue providing interexchange service to the customer. The Commission has recognized that access service is an essential input for interexchange service, and that the ability to raise the price for access enables the access provider to unilaterally raise the price of interexchange calls between two points.[43]

Within a product market it is possible to identify and aggregate consumers with similar demand patterns. Within the local exchange access market, it is typically interexchange carriers (IXCs) that purchase these services, although large business customers purchase some dedicated access services. The two segments of customers to which IXCs require access can be separated into (1) residential and small business customers ("mass markets"), and (2) large business customers. Significant differences between these two segments include, but are not limited to, traffic volume, quality standards, and redundancy requirements.

A geographic market aggregates those consumers with similar choices regarding a particular good or service in the same geographical area.[44] In the LEC In-Region Interexchange Order, the Commission defined a geographic market as an area in which all customers in that

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[43] In the Matter of Policy and Rules Concerning the Interstate, Interexchange Marketplace and Implementation of Section 254(g) of the Communications Act of 1934, Notice of Proposed Rulemaking, 11 FCC Rcd 7141, 7169 (1996).

[44] See Tampa Elec. Co. v. Nashville Co. 365 U.S. 320, 327 (1961).

area will likely face the same competitive alternatives for a product.[45] The local exchange is a market of over $100 billion, dominated almost totally by the incumbent local exchange carriers who control more than 98 percent of local revenues and access lines. Insofar as MCI has been able to determine in assembling data for this report, all geographic local markets share the basic characteristic of near-total incumbent domination. For that reason, there is little reason to consider geographical differences in an analysis of the exchange access market

1. Market Forces Do Not Impact Terminating Switched Access

An interexchange carrier has no choice but to send a terminating call to the local exchange carrier that serves the line where the call is terminating. The interexchange carrier generally has no ability to change providers of terminating switched access, since that choice (to the extent there is a choice at all) is within the control of the individual to whom the call is terminating.[46] Moreover, the interexchange carrier has no ability, theoretical or otherwise, to influence the terminating user's choice of local exchange providers (again, assuming there even is a choice). This is because the user who receives the toll call in most cases does not pay (directly or indirectly) for the terminating switched access (the originator of the call pays indirectly via his/her toll charges). Consequently, since interexchange carriers cannot choose different terminate switched access providers and since the end users do not pay for terminating switched access, no market forces can be brought to bear upon terminating switched access.

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[45] LEC In-Region Interexchange Order at ¶21.

[46] In fact, NYNEX currently offers its customers a rebate depending on how much of their traffic is kept on their network.

2. Market Forces Have Little Impact on Originating Switched Access

As in the case of terminating switched access, an interexchange carrier has no choice in who provides it originating switched access. The interexchange carrier must purchase the originating switched access service provided by the local exchange carrier that is providing local service to the end user. However, unlike the case with terminating switched access, the end user does pay -- indirectly -- for the originating switched access charged by the local exchange carrier. This is because the toll rates that the end user originating a toll call pays includes the cost of the originating access charged by the local exchange carrier. Therefore, since the end user is paying indirectly for the originating access charged by the local exchange carrier, theoretically, competitive forces could be brought to bear on originating switched access. In theory, an IXC could charge lower toll rates to customers selecting a CLEC with lower access charges. Because the lower toll rates would provide an incentive for the end user customer to switch from the ILEC to the competing local exchange carrier, and thereby deprive the ILEC of access revenues, the ILEC would, in theory, have an incentive to reduce its access charges to competitive levels. However, while there is a theoretical possibility for market forces to work on originating switched access, in practice it will be very difficult for those forces to work -- and it will definitely take a lot of time even before those theoretical forces could potentially be a reality.

Before these "theoretical" forces could possibly work, absent the availability of UNEs, there would need to be effective, widespread, facilities-based local exchange competition. If there are no alternatives to the ILEC's switched access services, no amount of effort to avoid those charges can be successful. Next, IXCs would need to design and implement different toll calling plans that reflected different originating switched access of the various facilities-based

local exchange carriers.[47] Only in that way would end user customers receive the proper information regarding the variation in access costs. If those two conditions were present, customers of local exchange carriers *may* have some incentive and ability to change to local exchange carriers who had lower originating switched access rates (which in turn were reflected to the end user as lower toll rates). The local exchange competition must be facilities-based, not resale-based. Resale local exchange competition does not impart any pressure on the local exchange carrier's access rates because with resale the underlying carrier (the incumbent local exchange carrier) keeps all access revenue generated by the resale carrier's end users. Thus, from an access perspective, the ILEC is indifferent to resale competition. Only with facilities-based competition is the ILEC's switched access revenue potentially at competitive risk.

Facilities-based competition must also be effective. End users must have the ability to quickly and easily exercise their choice of local exchange carriers. On the interexchange side, end users can now, with equal access and low or zero cost to switch, easily change toll providers. On the local side, there is not comparable ease with which customers can switch local carriers. The lack of permanent number portability and existence of significant nonrecurring charges for switching local carriers, among other things, act as formidable barriers inhibiting customer choice of local carriers.[48]

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[47] Of course, there are legal and business issues that are presented by this condition, including:(1) whether a differentiated toll plan by LEC is discriminatory; (2) whether a differentiated toll plan survives the statutory requirement on geographically averaged rates; (3) whether it is possible to sustain differential pricing in a competitive market.

[48] Even if competition begins in the most densely populated urban areas, as one would expect it would initially, ILECs have been afforded unlimited downward

If differential pricing were to be implemented, MCI would have to assume that the different toll rates would be sufficient incentive for end users to choose one local exchange carrier over another. Common sense, however, dictates that the choice of a local carrier involves many considerations, including the price of the local exchange service, the price of optional features, and the quality of service In an independent survey conducted for MCI in Fall 1997 among 2,246 respondents who spend at least $1,000 per month on local and long distance, about four in ten (41%) indicate familiarity as a reason for choosing a local carrier. Half as many mention good customer service (20%) or good rates (19%) (note: this is different than "low" rates) as grounds for selecting a local provider. Less than one in ten mention reliability (8%), products/services available (6%), or that the company is established/well known (5%). Thus, at best, the lower price that an interexchange carrier can provide a potential customer of a local exchange carrier is only one of many considerations that go into the choice of a local exchange carrier.

The evidence supporting this analysis is apparent even at this nascent stage of local competition. MCI, the second largest national access customer and itself a competitive new entrant in 31 local markets, today purchases over 99 percent of originating traffic from ILECs:

B. All Evidence Shows That Competition Is Not Developing Sufficiently to Achieve the Commission's Goal of Reducing Interstate Access Charges to Forward-looking Economic Cost

Section 251 of the 1996 Act established three routes new entrants can take to compete in local markets. Each of these strategies involve different economic characteristics and different

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pricing flexibility to compete effectively.

physical arrangements. The first is pure facilities-based competition -- that is, the construction of competing networks. A new entrant constructing its own network facilities must be allowed to interconnect with the incumbent's network. Congress recognized that even with mandatory interconnection, this form of competition will take years to emerge "because the investment necessary [to build a competing network] is so significant."[49] In the Notice of Proposed Rulemaking in the Implementation of Local Competition Provisions of the Telecommunications Act of 1996, it was estimated that an investment of more than $29 billion would be required today to construct local networks capable of reaching even 20 percent of available subscribers.[50] MCI's view is that this level of investment would only cover the business market. According to HAI 5.0a, it would require approximately $158 billion of investment for new entrants to duplicate the price cap ILECs' local exchange network.

The second route for entry is leasing designated elements of the existing local network. Section 251 (c)(3) requires incumbents to provide to new entrants "non-discriminatory access to network elements on an unbundled basis...in a manner that allows requesting carriers to combine such elements in order to provide...telecommunications service." This provides new entrants with the flexibility to order some or all of the following basic components of the local network: (1) the network interface device attached to the outside of the home or business connecting the phone line to the wires inside the home or business; (2) the "loop," which is the line that runs from the network interface device at the customer's premises to the nearest switching center; (3)

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[49] See H.R. Conf. Rep. No. 104-458 at 148 (1996)(Conf. Rep.)

[50] See Implementation of Local Competition Provisions of the Telecommunications Act of 1996, Notice of Proposed Rulemaking, 11 FCC Rcd 14171 at ¶7 & n.15.

the telephone "switches" (to which the local loops connect) which are essentially large computers that direct calls to their intended destinations; (4) "transport" facilities, the facilities that carry calls between switches; and (5) databases, and other related support services. Making use of these elements, a new entrant could build its own switches and transport facilities while leasing wire loops and network interface device from the incumbent to reach customers' homes.

The third route is through resale of ILEC services.[51] ILECs must permit new entrants to purchase their retail services at wholesale rate so that new entrants can compete by reselling these services under a different brand to retail customers. While resale in theory allows quick and widespread entry, in practice it presents no opportunity for retail price competition. Because of the way that resale discounts are calculated, ILECs maintain every cent of profit when they resell local service. The resale discounts are insufficient, especially when one considers that a CLEC would generally need to discount its services compared to ILEC retail rates to attract customers. CLECs that offer local service through resale lose money. Additionally, in the Local Competition Order, the Commission concluded that the 1996 Act requires that ILECs continue to receive access charge revenues when local services are resold under §251(c)(4).[52] Thus, resale, even if it were an effective method of entry into the local exchange market, places no downward pressure on access rates.

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51 §251 (c)(4).

52 In that Order, the Commission states that IXCs must still pay access charges to incumbent LECs for originating or terminating interstate traffic, even when their end user is served by a telecommunications carrier that resells incumbent LEC retail services. See Local Competition Order at ¶980

The only evidence that would demonstrate that competitive entry was reducing ILEC access rates would be a consistent pattern of below-cap pricing. The Commission's clear expectation was that, under the market-based approach, competitive entry would drive ILEC prices below the cap and toward cost.[53] However, with very few exceptions, the price cap ILECs continue to price at the maximum allowed by the price cap index in every basket.[54] The reductions in access charges that have occurred since the adoption of the Access Charge Reform Order have been due entirely to the order's limited prescriptive measures, not to any market-based pricing discipline.

As is illustrated in the table below, all the RBOCs are pricing Common Line and Traffic Sensitive access services as high as permissible ("at cap") under the Commission's price cap rules. Even for interstate transport services, the services for which CLEC competition has been developing for nearly ten years, all the RBOCs except Ameritech and Nevada Bell are pricing at cap.

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53 The Commission has found that interstate access rates are well above cost. Access rate declines reflecting only the rate of ILEC productivity change would not move access charges any closer to forward-looking economic cost.

54 See price cap LEC tariffs effective January 1, 1998.

Table 5. RBOC Pricing of Access Services as of 4/1/98[55]

RBOC	Trunking Basket	Traffic Sensitive Basket	Common Line Basket
Ameritech	5.7% Below Cap	**At Cap**	**At Cap**
Bell Atlantic	**At Cap**	**At Cap**	**At Cap**
BellSouth	**At Cap**	**At Cap**	**At Cap**
SBC	**At Cap**	**At Cap**	**At Cap**
Pacific Telesis	**At Cap**	**At Cap**	**At Cap**
Nevada Bell	6.1% Below Cap	**At Cap**	**At Cap**
US West	**At Cap**	**At Cap**	**At Cap**

C. Measure of CLEC Market Share

CLEC market share data, measured by practically any manner, reveal the ILECs' dominance in the local exchange and exchange access markets.

1. Market Share By CLEC Facilities

According to Commission statistics, in 1996, the last year for which data are available, CLECs had deployed 1.3 million miles of fiber.[56] While this represents approximately one-tenth the 12.3 million miles of fiber deployed by the ILECs,[57] it also represents less than 1/1000th of

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55 Source: ILEC Tariff Review Plan Filings, April 1, 1998.

56 Fiber Deployment Update, End of Year 1996 by Jonathan M. Kraushaar, Industry Analysis Division, Common Carrier Bureau, Federal Communications Commission.

57 Fiber Deployment Update, End of Year 1996 by Jonathan M. Kraushaar, Industry Analysis Division, Common Carrier Bureau, Federal Communications Commission.

ILEC total transmission facilities (which includes 1.3 billion miles of copper).[58] This is an important measure of facilities-based competition because it illustrates that CLEC market reach through CLEC-owned facilities is extremely limited. It also helps explain why CLECs have only 15,667 buildings located on their networks as of fall 1997, representing 0.33 percent of commercial buildings, and less than 0.013 percent of households and commercial buildings.[59]

Table 6. 1997 CLEC Share of Commercial & Residential Buildings, Nationally

	Business		Residential		Total	
	ILEC	CLEC	ILEC	CLEC	ILEC	CLEC
Number (millions)	4.6	.015	112	-	116.5	0.015
Percent	99.67%	0.33%	100%	-	99.99%	0.001%

Table 7. CLEC Share of Commercial & Residential Buildings By, Region

Region	ILEC Commercial Buildings	Total ILEC Households & Commercial Buildings	CLEC Percent of Commercial Buildings	CLEC Percent of Households & Commercial Buildings
Northeast	739,500	22,700,100	0.435%	0.014%
Midwest	1,161,780	27,696,060	0.164%	0.007%
South	1,785,000	41,989,320	0.335%	0.014%
West	983,280	24,280,080	0.464%	0.019%
Total	4,669,560	116,665,560	0.336%	0.013%

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58 1997 Statistics of Communications Common Carriers, Common Carrier Bureau, Federal Communications Commission, December 5, 1997, Table 12.

59 CLEC building data based on MCI market research, and represent buildings that take less than 30 days to provision. ILEC housing estimates based on U.S. Bureau of the Census, Estimates of Housing Units and Households of States: April 1, 1990 and July 1, 1996, Table 1 (ST-96-20T). ILEC commercial building information based on US Energy Information Administration, Department of Energy, Commercial Buildings Characteristics, 1995, Table 3. MCI increased the 1995 household and commercial building numbers by 2 percent, to represent a conservative estimate of growth since 1995.

Additionally, the fiber miles numbers illustrate the relative ease of an ILEC to deploy new facilities throughout, compared to new entrants. This is, in part, due to such factors as limited CLEC capital which must be raised from the financial markets or through debt, and CLEC delays in receiving rights-of-way and building-entry permits.

The efforts of CLECs to increase the percentage of buildings served by CLECs are seriously hampered by two factors.

First, it is difficult for CLECs to obtain the public approvals and capital necessary to construct the fiber rings that will serve the buildings. Many cities and counties require each CLEC to execute a right-of-way franchise agreement prior to placing facilities in the public rights-of-way. The very process of negotiating such an agreement is a time-consuming hurdle generally not faced by the ILECs. And the substance of the franchise agreement often requires the CLEC to provide consideration to the jurisdiction and to perform other obligations not required of the ILEC. This disparity of treatment discourages the deployment of additional fiber.

The second and more important factor inhibiting the rate of building penetration is the refusal of most landlords to allow CLECs to provide service in their building without payment of compensation -- compensation that is almost never demanded from ILECs. This places CLECs at a competitive disadvantage in terms of the cost of providing service. Furthermore, the CLECs must make a difficult decision regarding the allocation of scarce capital. Ideally, given the necessity of paying landlords, the CLEC would prefer to make the commitment to enter a building only after obtaining contracts to provide service to customers in that building. But given the several months minimum delay that would result in order to design and build the building entrance facility, place the terminating equipment and design and install the internal

wiring to reach the customer, obtaining the landlord's approval of plans and specifications along the way, some CLECs will risk capital by committing to certain buildings and the associated costs of entry prior to having a signed customer contract. Others will wait for the customer contract, but the resulting lengthy time for delivery of service will make the sales efforts more difficult. The combination of the foregoing problems introduces uncertainty to the business plan, which makes it all the more difficult for CLECs to obtain the large amounts of capital they need to deploy local facilities.

2. CLEC Use of Unbundled Network Elements

The Commission's adoption of the market-based approach to access reform was based primarily on its prediction of widespread UNE-based local competition.[60] The Commission specifically cited the requirement that ILECs lease UNEs at cost as generating the competitive pressures that would constrain ILEC access charges.[61] Further, the Commission stated that, if CLECs did not have the ability to offer local exchange and exchange access services over UNEs

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60 Access Charge Reform Order at ¶262 ("As we have recognized, interstate access services can be replaced with . . . . functionality offered by unbundled elements."); See Access Reform Notice at ¶170 ("Unbundled network elements provide a ubiquitous substitute for access service."); Access Charge Reform Order at ¶280 ("Therefore, so long as an incumbent LEC is required to provide unbundled network elements quickly, at economic cost, and in adequate quantities, an attempted price squeeze seems likely to induce substantial additional entry in local markets.").

61 Access Charge Reform Order at ¶32.

priced at forward-looking economic cost, it would have been compelled to take a more prescriptive approach to access reform.[62]

However, since the Commission adopted the Access Charge Reform Order, new entrants' reliance on unbundled elements has been stalled by the absence of forward-looking cost-based prices for unbundled network elements in many areas of the country, the inability of new entrants to obtain combinations of network elements at economic cost, and the continued foot-dragging of the incumbents in implementing operations support systems (OSS).[63]

The RBOCs and GTE recently provided the following information to the Commission in response to a Commission-initiated survey of local competition.[64] The RBOCs & GTE reported that RBOCs continue to receive access revenue on all but 123,680 lines which are served by

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62 Access Charge Reform Order, ¶337 n.490 ("There would be serious questions about the wisdom of a market-based approach to access reform as advocated by some incumbent LECs if incumbent LECs could impose access charges on the use of unbundled network elements); Id. n.491 ("Were we to allow the assessment of access charges by incumbent LECs for access services provided by carriers over unbundled network elements, we would be compelled to take a more prescriptive approach to the rate level issue.").

63 It must be emphasized that OSS is much more than just the interface used for ordering ILEC services, and that CLECs such as MCI continue to experience significant billing issues with UNE combos. See attached affidavit by Linda Cross.

64 On February 20, 1998, a limited number of large telephone companies were asked to complete--on a voluntary basis -- a short survey on the state of local competition at the end of 1997 for each state in which the company or affiliate (defined by direct or indirect ownership or control of a majority interest) serves as an incumbent local exchange carrier. The information requested in the survey was intended to facilitate the development of a consistent set of data for analyzing the state of local competition in all areas of the country. ILEC UNE data in the following tables is compiled from the electronic survey responses from these ILECs, which the FCC received in March, 1998.

CLECs through unbundled network elements. In other words, the data provided by these ILECs demonstrates that CLECs serve less than 0.09% percent of access lines in the RBOC and GTE territories.[65]

Table 8. CLEC Market Share by Unbundled Network Elements, by Region, March 1998

RBOC Region	Total Lines	Unbundled Network Elements	CLEC Market Share Through UNEs
AIT	20,612,210	68,134	0.33%
BEL	33,396,306	32,431	0.10%
BLS	23,153,182	8,448	0.04%
GTE	17,750,056	387	0.00%
SBC	33,487,936	13,940	0.04%
USW	16,121,235	340	0.00%
TOTAL	144,520,925	123,680	0.09%

As a measure of how insignificant the number of unbundled loops purchased by CLECs is, the RBOCs and GTE are expected to add 6 million access lines between 1997 and 1998.[66] Industry analysts predict that RBOC and GTE access lines growth will be driven by continued demand for second-lines.[67] RBOC and GTE secondary lines are expected to increase 15.5% to 17.2 million, and account for 16.7% of residential lines in 1998.[68]

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[65] When analyzed by specific RBOC & GTE region or by state, the monopoly power of the RBOCs is no less prevalent (see Appendix D).

[66] Earnings releases, Credit Suisse First Boston, March 11, 1998.

[67] Earnings releases, Credit Suisse First Boston, March 11, 1998.

[68] Earnings releases, Credit Suisse First Boston, March 11, 1998.

Table 9. RBOC & GTE Access Lines by Type

(000's lines)	1997	Est'd Growth 1998E	1998E
Primary	84,412*	1.7%*	85,879+
Second lines	14,878*	15.5%*	17,184+
Residential	99,290~	3.8%*"	103,063+
Business	50,231~	4.6%*"	52,542+
Other^	4,950~	6.3%"	5,263«
Total access lines	154,471~	4.1%*"	160,868+

* 1997A primary/secondary lines and 1998E growth rates: Credit Suisse First Boston
+ 1998E lines = 1997 actual * (1 + 1998E growth rate)
~ 1997 actuals: earnings releases
" Weighted average
^ Other includes special access, payphone. Each company may define slightly differently.
« 1998 other lines = total - residential - business

Without widespread availability of unbundled elements priced at forward-looking cost, the competitive provision of switched access services is occurring only in the extremely limited situations where competitors are able to serve customers using their own facilities. Consequently, competitive entry is well short of the scale necessary to constrain ILEC access rates.

3. CLEC Reach Through Collocation

Because of their limited network reach, CLECs must establish collocation cages and purchase unbundled loops to serve additional end user customers. In addition, providers of competitive transport services must collocate at ILEC offices in order to interconnect with ILEC switched access services. Today's pricing and provisioning problems, some of which have been

noted in the section 271 cases examined to date, have limited this form of entry. Collocation today does not provide even an opportunity for widespread local competition and access competition, as illustrated by the following example. However, even assuming the most optimal conditions, MCI estimates that CLEC reach in major metropolitan[69] areas is limited to approximately 7 percent on average.[70]

However, these estimates are based on the unlikely scenario that new entrants could fully utilize collocation arrangements. This is unlikely for several reasons. First, it is unlikely that all collocation arrangements will be at the maximum 400 square feet permitted due to space limitations. Second, it is unlikely that the CLECs will gain 10,000 lines in a given office any time soon. CLECs are generally prevented from offering ubiquitous services through collocation arrangements since they do not have arrangements in all central offices. As a result, CLECs typically do not mass market services offered through collocation, but concentrate on face to face sales. Finally, as the Commission is aware, the economics of collocation in most areas is not favorable due to interim pricing that is well-above economic cost. In these circumstances, only customers with very high traffic volumes can "prove in" a collocation facility.

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[69] Atlanta (LATA 438), Baltimore (LATA 238), Boston (LATA 128), Chicago (LATA 358),Cleveland (LATA 320), Denver (LATA 656), Detroit (LATA 340), Houston (LATA 560), Los Angeles (LATA 730), Miami (LATA 460), Newark/Phil (LATA 222/4/8), New York City (LATA 132), Phoenix (LATA 666), Pittsburgh (LATA 234), Portland (LATA 672), San Antonio (LATA 566), San Diego (LATA 732), San Francisco (LATA 722), and Seattle (LATA 674)

[70] Base on MCI market research, in these LATAs there were approximately 56 million lines and 405 active collocation arrangements in these LATAs in the Fall of 1997. MCI assumes that a "fully utilized" collocation arrangement could serve 10,000 lines, typically limited by either physical space or ILEC space restraints to 400 square foot arrangements.

4. Regulatory Agency Findings Regarding Local Competition in Various States

The results of this study confirm what state Commissions that have studied the status of local competition have found -- that CLECs have only a minuscule market share. As shown in Appendix E, which summarizes recent state Commission evaluations of local competition, state Commissions have uniformly found that competitive entry is insufficient to constrain prices in any way. For example, the Michigan Public Service Commission (PSC) recently found that the marketplace for local services in Michigan is dominated by Ameritech and GTE, and that "a truly open marketplace remains a goal, not a reality."[71] Similarly, the Florida PSC found that "there are developing signs that local competition may be more on the distant horizon than on the near one."[72]

IV. IXC Reliance on ILEC Access Is Not Likely to Change

As a result of the new regulatory paradigm provided by the Telecommunications Reform Act of 1996, and due to financial, competitive, and technical reasons, many access customers, such as MCI, have made a concerted effort to diversify their local access providers (e.g., by moving traffic to access providers other than the ILEC). MCI, perhaps more than any other IXC, has attempted to inject competition into the exchange access market by investing $2 billion in local facilities in 31 markets. Upon completion of the merger with WorldCom, the combined

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[71] Report to the Michigan Governor and Legislature on Public Act of 1991 as amended, Section 353, February 1998, submitted by the Michigan Public Service Commission, Michigan Department of Consumer and Industry Services, In Compliance with Public Act 179 of 1991, as Amended by Public Act 216 of 1995)(Report to the Michigan Governor and Legislature).

[72] Local Telecommunications Competition, September 19, 1997 Draft, at 9.

company will offer competitive local exchange services in over 100 markets. In addition, MCI has pursued innovative partnerships with rural telephone companies and other utilities to bring competition to rural America for local and other telecommunications services.

However, as is illustrated by the attached declarations from MCI executives whose responsibility is to manage access arrangements and cost, given the limited availability of CLEC facilities and capacity, the significant termination liability and nonrecurring charges associated with moving traffic from ILEC networks to CLEC networks, and Commission orders protecting ILEC revenues, it has been possible to place only a portion of new (growth) access traffic with new entrants.[73] ILECs typically continue to originate and terminate almost all of the embedded access traffic.[74]

The attached declarations of MCI executives included in this document, support the evidence that exchange access competition is far from flourishing. Their statements show that despite MCI's constant efforts to identify and utilize alternative providers of access services, ILECs still provide virtually all of the originating and terminating access services which MCI requires.

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[73] See Appendix F.

[74] Although it is possible for MCI to move traffic to CAPs when ILEC long-term contracts expire, the ILEC pricing schedules often make this option uneconomical. The ILECs design their pricing to ensure that large volume customers are only eligible to receive steep price discounts when they commit to long-term contracts (five years or longer). Therefore, in many cases it is simply more economical for MCI to re-sign with an ILEC rather then pay the costs to migrate to the CAP, even when the CLEC offers slightly lower recurring prices. Moreover, since many ILECs offer plans that provide discounts based on the total number of circuits in a LATA or territory, MCI must often factor in the effects on the costs of all of its remaining ILEC circuits before it can commit to a CAP.

These affidavits show that alternative providers account for an extremely small portion of MCI's switched access needs. Despite MCI's consistent efforts to identify and utilize alternative access providers, in the fourth quarter of 1997, less then 1 percent of MCI's total switched access costs were with alternative providers. In addition, less than 10 percent of MCI's total dedicated switched and special access circuits were purchased from alternate access providers.

Three factors severely constrain MCI's ability to migrate its traffic to alternative providers: (1) the relatively small number of end user customers served by these providers; (2) the limited networks of these providers; and, (3) excessive ILEC termination liabilities.

The limited networks of alternative providers constrain their ability to gain end user customers and constrain MCI's ability to migrate significant amounts of its access traffic off of the ILEC networks. Thus for the foreseeable future, ILECs will continue to provide MCI with the vast majority of its required switched access services. Moreover, as discussed above, even when alternative facilities exist, it is often infeasible for MCI to move traffic to the competitive provider because of high termination liabilities, non-recurring charges and administration charges.[75]

The recent actions by the Commission have not been helpful to alternative providers. Under the May 1997 First Report and Order on Access Reform, IXCs would no longer have been required to pay a substantial portion of the TIC when using alternative transport providers. While alternative providers were building out their networks to take advantage of this long-

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[75] For example, if MCI attempts to cancel a five year contract after the third year, it must pay the difference (for each circuit) between the five year discount rate and the three year discount rate. This can result in a significant and "show-stopping" cost for MCI, especially on the large contracts that are precisely the ones competed for by the CAPs.

justified opportunity, the Commission issued its Second Order on Reconsideration, in October 1997, which greatly reduced the portion of the TIC that could be avoided. Consequently, MCI reduced its planned orders from alternative providers by more than 75 percent.

MCI and other potential CLECs are also being stymied in their attempts to enter the local market and self-provision access. Although legal barriers to entry have now been removed by the Act, many economic barriers still remain. It is difficult for MCI to compete for residential customers who pay subsidized low dial tone line rates. Moreover, in most states, rates for unbundled network elements have not been set at forward looking costs, and are only interim charges.

Because of all these factors, there is neither widespread, existing competition among exchange access providers, nor any reasonable prospect for the development of such competition in the near future. MCI is and will continue to be reliant on the access offerings of the ILECs.

As the attached affidavit of Dr. Kelley shows, the Commission should expect that it will take many months or even years before competition could be expected to constrain ILEC access charges. Facilities-based entry will require substantial network investments over a period of years. Even assuming that UNEs are reasonably priced and available in commercially useful quantities, competitors must build supporting organizations and market to end user customers. The evidence from the long distance market is that the competitive process could take the better part of a decade. In the meantime, consumers will suffer substantial welfare losses, unless the Commission acts immediately to reduce access charges to economic cost.

V. Conclusion

It is clear that competition is not developing at a pace sufficient to constrain ILEC access rates in the foreseeable future. The above analysis shows that CLECs have less than one percent of the market for switched access services, and that prospects for significant changes in this statistic are dim.

The study confirms that the fundamental assumption of the Access Charge Reform Order -- that UNEs would enable significant competition in a reasonable time frame -- has been invalidated. Unbundled network elements are not available at forward-looking economic cost throughout the country and ILECs refuse to combine network elements for CLECs. There is no prospect that these roadblocks will be cleared in the near future.[76]

Without widespread availability of UNEs priced at forward-looking economic cost and available in combinations, competitive entry cannot occur fast enough to put downward pressure on ILEC access rates in the foreseeable future.[77] As the findings of this study clearly illustrate,

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[76] While the Supreme Court has agreed to hear the Commission's appeal of the 8th Circuit's decision, it is not expected that a decision will be handed down before the end of 1998. Even if the decision is issued by the end of 1998, it will take additional time for it to be implemented.

[77] In fact, the Commission pre-empted the portions of the Texas Public Utility Regulatory Act which required new entrants to build extensive facilities in order to compete in local markets. In its preemption order, the Commission recognized that "Congress expressly recognized that construction of redundant networks would be very costly and time consuming...."In the Matter of The Public Utility Commission of Texas; The Competition Policy Institute, IntelCom Group (USA), Inc. and ICG Telecom Group, Inc., AT&T Corp., MCI Telecommunications Corporation, and MFS Communications Company, Inc.; Teleport Communications Group, Inc.; City of Abilene, Texas; Petitions for Declaratory Ruling and/or Preemption of Certain Provisions of the Texas Public Utility Regulatory Act of 1995, CCBPol 96-13; CCBPol 96-14; CCBPol 96-16; CCBPol 96-19, 1997, Released October 1, 1997; Adopted September 26, 1997, at ¶79.

the pace of facilities-based entry is, almost by definition, severely constrained by the time required to construct facilities or collocations and by the need for massive levels of investment. Because facilities-based local competition is starting from a base of zero, CLEC market entry based on a pure facilities-based strategy or limited use of UNEs will take years to have any effect on the level of interstate access charges.

The continuation of above-cost access charges, without prospect for change, violates Section 254(b)(5) of the 1996 Act, which requires that all subsidies be made explicit. Once the hidden subsidies to support universal service are made explicit, as requires by the Act, there is absolutely no legitimate reason to permit the incumbent LECs to charge above the forward-looking economic cost for access. Any amounts above and beyond what are identified for the universal service subsidy are nothing more than an unlawful and implicit subsidy for ILECs and their shareholders.

The Commission must immediately change course and adopt a prescriptive measures to reduce interstate access charges to forward-looking economic cost. As the Commission recognized in the Access Reform Order, above-cost access charges suppress demand for interstate interexchange services, impede the efficient development of competition in the local and long distance markets, and retard economic growth. With no prospect that the amount by which access is above cost will erode by competitive pressures, the Commission's legal obligation, and its obligation to act in furtherance of Congressional policy favoring competition in all telecommunications markets, is to use its prescriptive power to reduce interstate access charges to forward-looking economic cost.

APPENDIX A

COMPETITION HAS NO SIGNIFICANT IMPACT ON ILEC OPERATING EARNINGS OR CASH FLOW MARGINS

It is clear that competition is not developing at a pace that could place competitive pressure on ILEC access rates any time soon. As is illustrated above, by any measure, CLEC market share is no more than one percent of the local access market. What is also clear is that ILEC profitability has not been negatively impacted by CLEC activities, or by the Commission's decision to increase the ILEC productivity factor to 6.5 percent.

Table A1. ILEC Earnings on Interstate Price Cap Services, 1991-1997

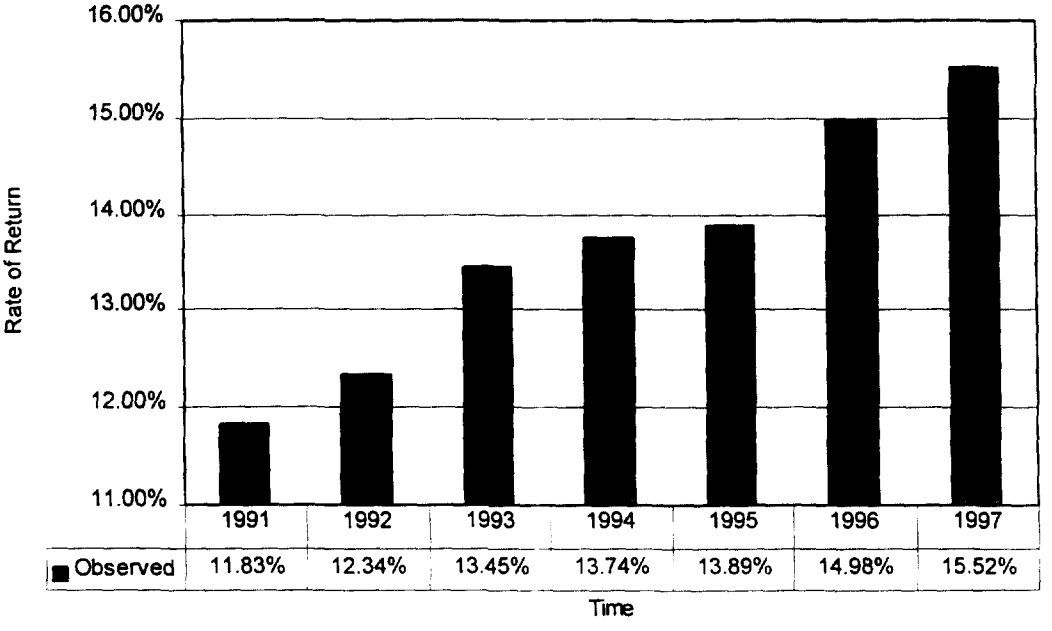
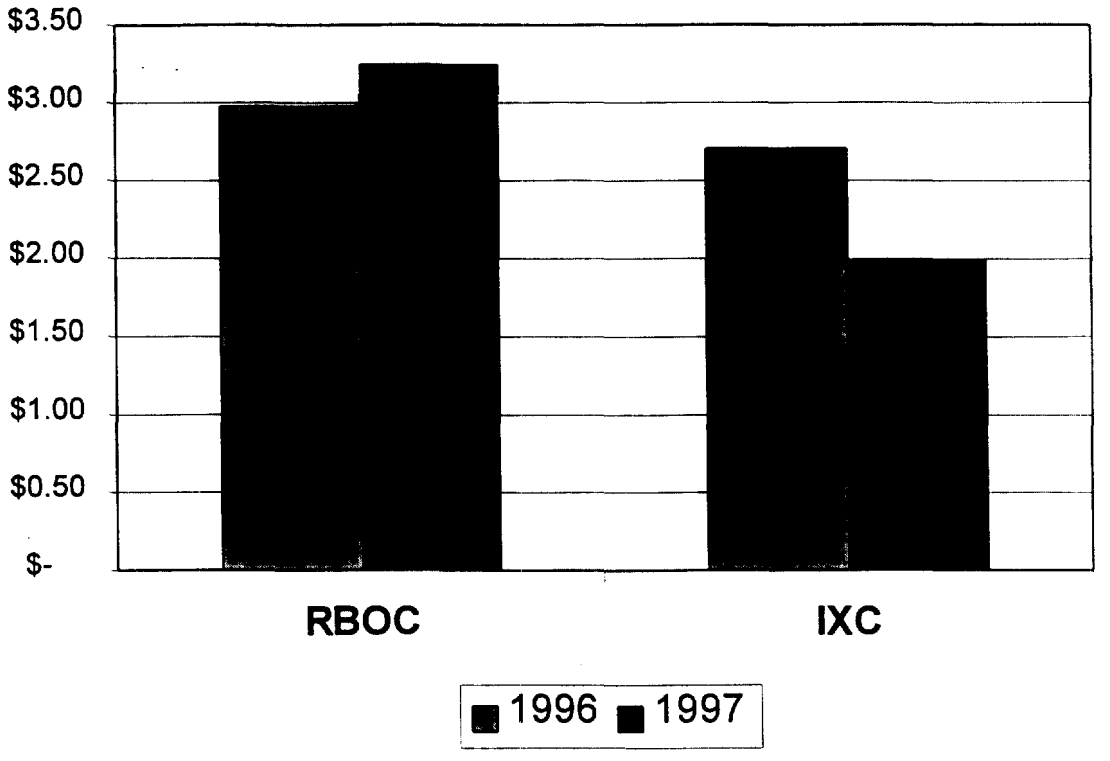


Table A2. RBOC 1997 Earnings Grew 11.3% While IXCs' Earnings Decreased 11.2%



As table A3 below demonstrates, RBOC and GTE monopoly earning on access services continue to be excessive. ILECs are receiving nearly a 70 percent cash flow from access charges -- a level unmatched by any other segment of the telecommunications business. By comparison, ILEC cash flow on their local operations is slightly over 20 percent.